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STATE FOR WHA/CAN
TREASURY FOR INTERNATIONAL AFFAIRS (FAIBISHENKO)
COMMERCE FOR 4320/ITA/MAC/WH/ONIA (WORD)

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TAGS: ECON EFIN PGOV CA
SUBJECT: Canada's federal budget provides lots of cash to provinces, includes benefits for American interests.

REF: Ottawa 505

¶1. (U) Summary: Canadian Finance Minister Jim Flaherty laid out the government's budget on March 19 with the lion's share of new spending, C$39 billion, directed toward the provinces in the effort to create 'Fiscal Balance' in the federation. As expected, it is an "election" budget crafted to provide benefits to many segments of the Canadian public in order to help the Tories win a majority in the next election. The budget also included several measures of specific interest and benefit to the United States, including elimination of withholding tax on interest paid to all non-residents; doubling to C$400 the value of goods that may be imported duty- and tax-free by returning Canadian residents after a 48-hour absence; and providing C$11 million over the next two years to clean up contaminated sediment in eight areas of concern identified under the Canada-United States Great Lakes Water Quality Agreement. The budget also confirms funding for Windsor-Detroit highways and bridge infrastructure. Opposed by the Liberals and the NDP, the budget nevertheless should have enough support from the Tories and the Bloc Quebecois to allow its passage through Parliament; the government will not fall on a budget no-confidence vote. Budget documents are available on-line at www.budget.gc.ca/2007/index_e.html End Summary

¶2. (U) The Tory budget, characterized by one media pundit as a "motherhood and apple pie document" will be supported by the Bloc Quebecois and therefore will have enough support to pass through Parliament despite the announced opposition of the Liberals and the NDP. Thus, the Tory government is not expected to fall next week on a no-confidence vote triggered by this budget.

Major Fiscal Elements of the Budget

¶3. (U) The Harper Government's budget announcement of March 19 noted that the overall fiscal situation is stronger than projected at the time of the November 2006 Economic and Fiscal Update, due to a combination of higher revenues and lower expenses. Partly as a result, Federal revenues as a share of GDP are projected to decline from 16.2 per cent in 2005-06 to 15.5 per cent in 2008-09.

¶4. (U) For FY 2006-07 (which ends on March 31), the Government is planning to reduce the federal debt by $C9.2 billion. Combined with last year's $C13.2-billion surplus, federal debt will have been reduced by $C22.4 billion over two years. The Government is planning on annual debt reduction of at least $C3 billion in 2007-08 and 2008-09, and remains on target to lower the federal debt-to-GDP ratio to 25 per cent by 2012-13. The government, with this budget plan, will direct over $C1 billion per year in debt interest savings to ongoing personal income tax reductions. And the Government will limit growth in program spending, on average, to below the rate of growth in the economy.

¶5. (U) Detailed analysis of economic developments and prospects can be found at: http://www.budget.gc.ca/2007/bp/bpc2e.html

Lots of Money to the Provinces, but not everyone is pleased

¶6. (U) A cornerstone element of the budget is the transfer of C$39 billion over the next seven years by the federal government to the provinces and territories. A key objective of this fiscal transfer is 'long-term, predictable funding for infrastructure' which will see federal support grow from C$3.2 billion per year when the Tories came to power last year, to nearly C$5.7 billion per year by
Qcame to power last year, to nearly C$5.7 billion per year by
2013-14. The Tories point out that this will add up to more than C$16 billion in new funding for infrastructure (roads, mass transit, water works, sewers and so on) over the next seven years. Indeed, according to the budget plan, cash funding to provinces and territories, which stood at C$43 billion per year when the Conservatives took office in 2006, will be at least C$18 billion higher in 2013-14. Combined with the money, however, is a promise by the Tories to meddle less in the policy affairs of provinces by focusing its spending in core areas of federal responsibility (presumably such as defense and national security) rather than in provincial matters such as health and education. That is, the provinces will still get cash transfers, from equalization and the 'Canada Social Transfer', infrastructure grants and other mechanisms but with fewer federal dictates on how the money it is to be spent.

¶7. (U) Despite this seeming magnificent largesse, however, not all provinces are greeting the budget with pleasure. By all accounts Quebec and Ontario are pleased, indeed many observers see the new funding as an attempt to influence the Quebec provincial election on March 26 (see reftel) but the premiers of Saskatchewan and Newfoundland and Labrador have both characterized the budget's plan

for provincial transfers as a 'betrayal'. This is due to the fact that both provinces have growing revenue streams from natural resource royalties and in recognition of those monies the federal government plans to reduce equalization payments to the provinces.

¶8. (U) Comment: The Conservative government's stated approach is to have clearly delimited provincial and federal areas of responsibility and limit federal spending activity to within its agreed upon purview. Given the relative weakness of the central government in Canada, past federal governments tried to implement national policies by using the federal purse to co-opt, coerce, or downright buy provincial acquiescence on federal policy initiatives in what is known broadly as 'fiscal federalism'. Upon taking power in 2006 the Tories identified concerns about how this approach blurred accountability to taxpayers and reduced clarity with respect to roles and responsibilities of each order of government which in turn helped create tension in the federation. This budget is a fairly comprehensive attempt to address that concern. End comment.

¶9. (U) The fiscal balance component of the budget is available at: http://www.budget.gc.ca/2007/themes/bkrfbse.h tml

¶10. (U) Other aspects of the budget such as funding for environment and energy programs, science and technology, defense and national security and other sectors will be addressed septel.

Good News for U.S. Priorities

¶11. (U) The budget also included several elements that will yield benefits to American interests. The government announced its intent to conclude negotiations on the Canada-US Tax Treaty soon and the related elimination of withholding tax on interest paid to all non-residents, to be phased in over three years following the signing of the new treaty. The budget doubles the value of goods that may be imported duty- and tax-free by returning Canadian residents after a 48-hour absence, to C$400, effective March 20,
¶2007. And it reaffirms the federal government's commitment to construct a new border crossing at Windsor-Detroit including plans

to cover 50 per cent of the cost of the access road from the new crossing to link up with Highway 401 (the major east-west artery of Ontario).

¶12. (U) Other budget items which will have a near-term impact on American private interests include a "Cabinet Directive on Streamlining Regulation" that will come into effect on April 1, 2007 and serve to focus resources on larger, more significant regulatory proposals, hold the government to account by establishing service standards, and create pressure for continual improvement through periodic reviews of the regulatory process. And the budget allocates C$11 million over the next two years to clean up contaminated sediment in eight areas of concern identified under the Canada-U.S. Great Lakes Water Quality Agreement: Hamilton Harbor, Niagara River, Detroit River, St. Mary's River, Thunder Bay, Peninsula Harbor, St. Clair River and Bay of Quinte, as well as providing C$5 million over the next two years to the International Joint Commission (IJC) to carry out a study with the U.S. on the flow of water out of Lake Superior.

Wilkins